

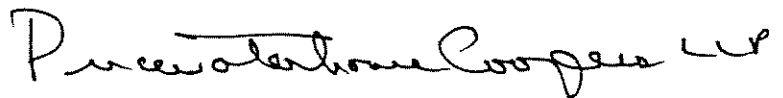
**PACT: HELPING CHILDREN
WITH SPECIAL NEEDS, INC.**

**Report of Independent Auditors on Financial Statements for the
years ended June 30, 2004 and 2003**

Report of Independent Auditors

To the Board of Directors of
PACT: Helping Children with Special Needs, Inc.

In our opinion, the accompanying balance sheets and the related statements of operations and changes in net assets and cash flows present fairly, in all material respects, the financial position of PACT: Helping Children with Special Needs, Inc., an affiliate of Kennedy Krieger Institute, Inc. ("the Institute"), at June 30, 2004 and 2003 and the results of its operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of PACT's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.



August 12, 2004

PACT: Helping Children With Special Needs, Inc.
Balance Sheets
as of June 30, 2004 and 2003

ASSETS	2004	2003
Current assets:		
Cash and cash equivalents	\$ 128,328	\$ 13,591
Accounts receivable	261,924	375,429
Assets limited as to use	806,840	841,957
Grants receivable	111,937	240,182
Pledges receivable	30	455
Total current assets	<u>1,309,059</u>	<u>1,471,614</u>
Non-current assets:		
Property and equipment, net	42,139	11,304
Total non-current assets	<u>42,139</u>	<u>11,304</u>
 Total assets	 <u>\$ 1,351,198</u>	 <u>\$ 1,482,918</u>
 LIABILITIES AND NET ASSETS		
Current liabilities:		
Accrued expenses	\$ 108,405	\$ 127,188
Deferred grant revenue	63,650	169,484
Total current liabilities	<u>172,055</u>	<u>296,672</u>
Net assets:		
Unrestricted	372,273	343,834
Temporarily restricted	806,870	842,412
Total net assets	<u>1,179,143</u>	<u>1,186,246</u>
 Total liabilities and net assets	 <u>\$ 1,351,198</u>	 <u>\$ 1,482,918</u>

The accompanying notes are an integral part of these financial statements.

PACT: Helping Children With Special Needs, Inc.
Statements of Operations and Changes in Net Assets
for the years ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Patient service revenue	\$ 771,581	\$ 826,421
Day care revenue	732,989	678,172
Community service grants and contracts	1,143,935	1,268,713
Net assets released from restrictions for operating activities	<u>156,544</u>	<u>308,989</u>
Total operating revenues	<u>2,805,049</u>	<u>3,082,295</u>
Operating expenses:		
Salaries, wages and benefits	2,279,033	2,498,751
Supplies and other	474,813	555,471
Bad debt expense	37,495	43,075
Depreciation and amortization	<u>10,269</u>	<u>8,496</u>
Total operating expenses	<u>2,801,610</u>	<u>3,105,793</u>
Excess of operating revenue over (under) operating expenses	3,439	(23,498)
Non-operating activity:		
Net assets released for property and equipment	<u>25,000</u>	<u>3,618</u>
Unrestricted net assets:		
Change in unrestricted net assets	28,439	(19,880)
Unrestricted net assets, beginning of year	<u>343,834</u>	<u>363,714</u>
Unrestricted net assets, end of year	<u>372,273</u>	<u>343,834</u>
Temporarily restricted net assets:		
Special purpose contributions	146,002	109,042
Net assets released for property and equipment	(25,000)	(3,618)
Net assets released from restrictions for operating activities	<u>(156,544)</u>	<u>(308,989)</u>
Decrease in temporarily restricted net assets	(35,542)	(203,565)
Temporarily restricted net assets, beginning of year	<u>842,412</u>	<u>1,045,977</u>
Temporarily restricted net assets, end of year	<u>806,870</u>	<u>842,412</u>
Decrease in total net assets	(7,103)	(223,445)
Total net assets, beginning of year	<u>1,186,246</u>	<u>1,409,691</u>
Total net assets, end of year	<u>\$ 1,179,143</u>	<u>\$ 1,186,246</u>

The accompanying notes are an integral part of these financial statements.

PACT: Helping Children With Special Needs, Inc.
Statements of Cash Flows
for the years ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Change in net assets	\$ (7,103)	\$ (223,445)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	10,269	8,496
Bad debt expense	37,495	43,075
Restricted contributions	(146,002)	(109,042)
Change in assets and liabilities:		
Decrease in accounts receivable	76,010	34,993
Decrease in grants receivable	128,245	207,357
Decrease in pledges receivable	425	200,485
(Decrease) increase in accrued expenses	(18,783)	40,022
(Decrease) in deferred grant revenue	<u>(105,834)</u>	<u>(199,524)</u>
Net cash flows provided by (used in) operating activities	<u>(25,278)</u>	<u>2,417</u>
Cash flows from investing activities:		
Purchase of property, plant and equipment, net	(41,104)	-
Decrease in assets limited to use	<u>35,117</u>	<u>3,080</u>
Net cash flows provided by (used in) investing activities	<u>(5,987)</u>	<u>3,080</u>
Cash flows from financing activities:		
Restricted contributions	<u>146,002</u>	<u>109,042</u>
Net increase in cash and cash equivalents	114,737	114,539
Cash and cash equivalents, beginning of year	<u>13,591</u>	<u>(100,948)</u>
Cash and cash equivalents, end of year	<u>\$ 128,328</u>	<u>\$ 13,591</u>

The accompanying notes are an integral part of these financial statements.

PACT: Helping Children With Special Needs, Inc.

Notes to Financial Statements

1. Description of the Organization

PACT: Helping Children with Special Needs, Inc. (PACT) is a Maryland non-stock corporation organized for charitable purposes and is tax exempt under Section 501(c)(3) of the Internal Revenue Code. PACT's sole member is the Kennedy Krieger Institute, Inc. (the "Institute").

PACT's mission is to promote the development of children with special needs and their families through programs providing comprehensive assessments, early intervention services, family support services, parent education, counseling and specialized childcare.

2. Summary of Significant Accounting Policies

Basis of Presentation

The financial statements of PACT have been prepared on the accrual basis that conforms to accounting principles generally accepted in the United States of America.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

Patient service revenue is reported at estimated realizable amounts from patients, third party payors, and others for services rendered. Day care revenue is reported based on amounts received or to be received from families and governmental sources. Grant and contract revenues are awarded from various governmental agencies and through agreements with other organizations. Revenue is recognized as the related project costs are incurred and recorded as expenses.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid instruments with original maturities of three months or less. These investments are carried at cost, which approximates market value. All cash balances are invested by the Institute.

Accounts Receivable

Accounts receivable are reported as amounts due from patients, third-party payers and others for services rendered. The mix of receivables due from patients and third-party payers at June 30, 2004 and 2003, are as follows:

	<u>2004</u>	<u>2003</u>
Medical Assistance	80.9 %	81.2 %
Blue Cross	5.7	9.0
Commercial Insurance	1.8	2.2
Managed Care	0.8	2.8
Self-pay and Tuitions	10.8	4.8
	<u>100.0 %</u>	<u>100.0 %</u>

PACT: Helping Children With Special Needs, Inc.

Notes to Financial Statements

Grants Receivable

Grants receivable are recorded when PACT receives a commitment from a granting agency, but where the receipt of funds has not occurred. These awards do not exceed one year and are classified as current assets.

Assets Limited As To Use

Assets limited as to use consist of cash and short-term investments, carried at fair value, that are donor restricted for capital and clinical program expenditures.

Property and Equipment

Property and equipment are stated at cost and depreciation is calculated on a straight-line basis over the estimated useful lives of the assets ranging from 3 to 10 years.

Pledges Receivable

Pledges receivable have been recorded as a result of the building fund campaign and other donor restricted and unrestricted contributions. All pledges at June 30, 2004 and 2003 are expected to be collectible (within one year).

Deferred Grant Revenue

Deferred grant revenue has been recorded to reflect the unused portion of grants awarded.

Unrestricted and Temporarily Restricted Net Assets

Unrestricted net assets represent those net assets utilized in the operating activities of PACT. Temporarily restricted net assets are those whose use by PACT has been limited by donors and grantors to a specific purpose or time period. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations and changes in net assets as net assets released from restrictions or as net assets released for property and equipment.

Reclassifications

Certain items in the 2003 financial statements have been reclassified to be consistent with the presentation in the 2004 financial statements.

3. Property and Equipment

A summary of property and equipment and the related accumulated depreciation at June 30 is as follows:

	<u>2004</u>	<u>2003</u>
Property and equipment, at cost	\$ 86,296	\$ 45,192
Less accumulated depreciation	<u>(44,157)</u>	<u>(33,888)</u>
Property and equipment, net	<u><u>\$ 42,139</u></u>	<u><u>\$ 11,304</u></u>

Certain fully depreciated furniture, fixtures and equipment and retired leasehold improvements from PACT's prior leased facility, which are no longer in service, have been eliminated from property and equipment.

PACT: Helping Children With Special Needs, Inc.

Notes to Financial Statements

4. Temporarily Restricted Net Assets

Temporarily restricted net assets as of June 30 were available for operating and capital expenditures as follows:

	<u>2004</u>	<u>2003</u>
Clinical programs	\$ 131,854	\$ 78,162
Building campaign	<u>675,016</u>	<u>764,250</u>
	<u>\$ 806,870</u>	<u>\$ 842,412</u>

During 2004 and 2003, \$156,544 and \$308,989 of net assets were released from temporarily restricted net assets after satisfying the restriction placed on the funds by the donor. These releases were reported in operating revenues. An additional \$25,000 and \$3,618 of temporarily restricted net assets were released in 2004 and 2003 for property and equipment and reported as non-operating activity.

5. Lease Commitments

PACT conducts its operations in facilities leased from Madison Street Properties (MSP), a wholly owned affiliate of the Institute. PACT's lease with MSP is on a year-by-year basis. Rental expense under this operating lease commitment for the years ended June 30, 2004 and 2003 amounted to \$269,765 and \$262,600, respectively.

6. Employee Benefits, Insurance and Other Administrative Costs

PACT participates in the Institute's employee benefit program. Employee benefits purchased through the Institute include retirement plans (defined benefit pension plan and 401k and 403b plans), health and dental insurance, workers' compensation, life and disability insurance, and unemployment insurance.

Professional liability and general liability insurance coverages are maintained by the Institute and includes the PACT operation. A portion of the cost is allocated to PACT through the general and administrative costs. In addition, other general and administrative costs are allocated from the Institute to PACT. These general and administrative costs include central administration, accounting, payroll, human resources, and information systems.

PACT: Helping Children With Special Needs, Inc.
Notes to Financial Statements

7. Functional Expenses

PACT provides services to children and families in several functional areas. Operating expenses within each area are summarized below:

	<u>2004</u>	<u>2003</u>
Program expenses:		
Comprehensive Therapy Center	\$ 827,141	\$ 934,328
Growing Together	212,468	206,280
Specialized Child Care	532,772	634,025
Within My World	776,700	801,186
Therapeutic Nursery	277,817	338,161
Total program expenses	<u>2,626,898</u>	<u>2,913,980</u>
Fundraising	67,797	72,836
General and administrative	<u>106,915</u>	<u>118,977</u>
Total	<u>\$ 2,801,610</u>	<u>\$ 3,105,793</u>